Edward B. Hatchett, Jr.
Auditor Of Public Accounts
2501 Georgetown Road, Suite #2
Frankfort, KY 40601
(502) 573-0050
ehatchett@kyauditor.net

GASB 34 Implementation Training

Presented by:

Office of Quality Assurance and Consultation

County Implementation List

- Phase I
  - Jefferson
  - Fayette
- Phase II
  - Boone
  - Campbell
  - Christian
  - Daviess
  - Franklin
  - Hardin
  - Harlan
  - Henderson
  - Kenton
  - Laurel
  - Madison
  - McCracken
  - Pike
  - Pulaski
  - Scott
  - Warren
- Phase III
  - All others

What is GASB?

- Governmental Accounting Standards Board
  - Responsible for developing standards of state and local governmental accounting and financial reporting that will
    - Result in useful information for users of financial reports
    - Guide and educate the public, including issuers, auditors and users of those financial reports

Questions and Answers

Q. Has DLG accepted the GASB 34 requirements, and will they offer counties assistance?

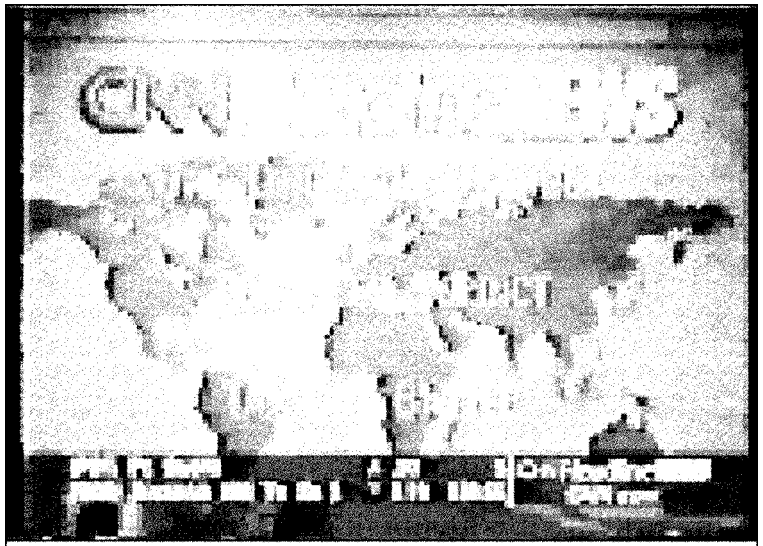
A. Several DLG employees have attended GASB 34 training, and are familiar with the new reporting model. Their role has not changed due to the new requirements, and therefore should continue to provide the same support services as in the past.

Questions and Answers

Q. If there is no statutory requirement for counties to follow GAAP, why should we implement GASB 34?

A. Implementing the GASB 34 reporting model will not affect the basis of accounting for counties. However, the new presentation requirements must be followed in order for independent auditors to issue a clean (unqualified) opinion on the financial statements.

CNN Report on GASB 34



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Capitalization Policy

Establish a Capitalization Policy

- Before you value your assets, the Fiscal Court must establish a capitalization policy.
  - This sets the threshold for reporting capital assets on the financial statements.
  - This keeps the bookkeeper from being overburdened by tracking immaterial assets for reporting purposes.
    - Inventory will still need to be tagged and tracked for internal control purposes.
  - The goal is to capture the material amounts or items of your inventory.

Capitalization Thresholds

- Example:
  - Equipment Threshold - $5000
  - Purchase of 40 handguns at $500 each = Total $20,000
  - Individually may not be significant, however, cumulatively may be material
  - May need to consider combining assets into groups

Questions and Answers

Q. What is the advantage of establishing a $5,000 capitalization threshold vs. a $1,000 threshold?

A. The capitalization threshold is at the county's discretion. However, setting a higher threshold may reduce the volume of work without greatly affecting the dollar amount reported in the financial statements but avoid setting too high and understating the county's assets.

Questions and Answers

Q. Are capitalization thresholds subject to change?

A. A county may change its capitalization threshold after it is initially established. However, the change should be documented and approved by the Fiscal Court.

Identifying Capital Assets

What are Capital Assets?

- Capital Assets are assets that have a useful life greater than one year.
- Infrastructure is considered a capital asset but is required to be reported separately and will be discussed separately.

Capital Asset Examples

- Land
- Buildings
- Vehicles
- Equipment
- All other tangible or intangible assets used in operations and with initial lives extending beyond a single reporting period

When do we have to do this?

All capital assets (land, buildings, vehicles, etc.) must be reported in implementation year!

Valuing Capital Assets

Historical Cost

- If you know the actual historical cost of the asset, use it!
  - Historical cost is original cost or purchase price of the asset.
  - Use the fair market value of donated assets at the time of the donation.
  - Include any installation expenses, such as:
    - Computer network installation

Estimating Historical Cost

(if you don't know actual historical cost)

- Estimate the construction cost for 2002 and deflate that cost to the year of construction.
- This historical cost estimate can be used when the actual cost is unknown.

Estimating Historical Cost for Buildings

- Assume building constructed in 1985 with no available construction cost records
- Estimate the construction cost of what it would cost to build today.
- Deflate back to the year of construction using a Building Cost Construction Index.
  - 2002 Construction Cost = $4,000,000
  - Construction Cost Index: 2428/3623 = 67%
  - Construction Cost Today x Cost Index Percentage
    $4,000,000 x 67% =

    1985 Estimated Historical Cost of $2,680,000

Exhibit 3 Building Construction Cost Index

Exercise #1
Calculating Estimated Historical Cost

- Building:
  - 30,000 square feet, 2 story
  - Fireproof structural steel frame
  - Construction Year: 1987
  - 2002 Construction Cost: $2.5 million or $85/sq. foot
  - 1987 Cost Index Average = 2541
    - Cost Index Percentage 2541/3623 = 70%
- Calculate Estimated Historical Cost

Exercise #1 - Solution

- Historical Cost Calculation
  - 2002 Construction Cost x Cost Index Percentage
  - $2,500,000 x 70%
  - 1987 Historical Cost Estimate = $1,750,000

Questions and Answers

Q. Can counties use KACo appraisals to value buildings?

A. When estimating historical costs, appraisals based on *current replacement costs* may be used to estimate current value and deflate to the appropriate year. However, counties should determine whether appraisals are based on replacement costs or an unacceptable basis for financial statement reporting (such as fair value).

Questions and Answers

Q. How should an asset be valued when time and materials were donated?

A. The donated time and materials should be valued at fair market value *at the time of donation*. These values may be combined with any historical costs that you know to arrive at a value for the entire asset.

Questions and Answers

Q. Should contents be included as part of a building's value?

A. No, the building and contents should be reported and valued separately.

Depreciating Capital Assets

Five elements must be known to calculate depreciation

1. Date the asset was placed in service
2. Historical cost or fair market value for donated items
3. Estimated useful life
4. Salvage value (if any)
5. Depreciation method
   - Straight-line Depreciation

Capital Asset Useful Lives

- Most capital assets have an identifiable useful life and can be depreciated over that life.
- Refer to examples of suggested useful lives-Exhibit 4 Useful Life Table.
  - These are only estimates and can be modified for assets with a particular usage to fit your situation.

Exhibit 4 Useful Life Table

Capital Asset Salvage Value

- The estimated value of the asset at the end of its useful life.

Questions and Answers

Q. Is a salvage value required for calculating depreciation?

A. No, the county may determine that some assets are scrapped at the end of their useful lives, or that no salvage value exists. In those situations, there is no requirement to arbitrarily set a salvage value.

Depreciation Approach

- Straight-line depreciation based on historical or estimated historical cost
- Provides accounting information

Cost of Asset

Less: Salvage Value

Depreciable Cost

Divided by: Useful Life

Depreciation Expense for each year

Accumulated Depreciation

- Total depreciation expense from acquisition thru current year
- Annual Depreciation Expense x Number of Years (thru June 30) = Accumulated Depreciation

	Historical Cost
Less:	Accumulated Depreciation
	Current Asset Value

Calculating Depreciation for Capital Assets

- 1985 Estimated Historical Cost = $2,680,000
- (Historical Cost - Salvage Value) divided by Useful Life = Depreciation Cost per year
  - **($2,680,000 - $20,000)/35 years = $76,000 Annual Depreciation**
- Age of Asset x Annual Depreciation = Accumulated Depreciation
  - **18 years x $76,000 = $1,368,000 Accumulated Depreciation**
- Cost – Accumulated Depreciation = Asset Value at June 30, 2003
  - **$2,680,000 - $1,368,000 = $1,312,000 Asset Value at June 30, 2003**

Exercise #2
Calculating Depreciation

- Assume purchase of 10 computers at $2,100 each
  - Total Cost = $21,000
  - Useful Life of 5 years
  - Placed in service July 2000
  - $1,000 Salvage Value

- Using the straight-line depreciation method, calculate the Annual Depreciation and Asset Value as of June 30, 2003

Exercise #2 - Solution

- **(Historical Cost – Salvage Value) divided by Useful Life = Depreciation Cost per year**
  - ($21,000 – $1,000) / 5 years = $4,000 Annual Depreciation
- **Age of Asset x Annual Depreciation = Accumulated Depreciation**
  - 3 years x $4,000 = $12,000 Accumulated Depreciation
- **Cost – Accumulated Depreciation = Asset Value at June 30, 2003**
  - $21,000 - $12,000 = $9,000 Asset Value at June 30, 2003

Identifying Infrastructure

Infrastructure Asset Examples

- Roads
- Bridges
- Tunnels
- Drainage systems
- Water and sewer systems
- Dams
- Lighting systems

Questions and Answers

Q. Are state or federal highways that run through a county reported in the county financial statements?

A. No, those assets will be reported by the state and federal governments.

Questions and Answers

Q. What about if a county shares some roads with a city? Which government should report those assets?

A. When the title to infrastructure is unclear, consider which government maintains the asset.

Valuing Infrastructure

Historical Cost for Infrastructure

- Use the actual cost of roads and bridges as historical cost *if you have the records*,
- If not, estimate what it would cost today to build the same roads and bridges.
  - Deflate the construction cost back to the year built using the infrastructure construction cost index.

Exhibit 5 Infrastructure Construction Cost Index

How to estimate historical cost for Infrastructure

- 100 miles of 20 ft. wide paved road built in 1982
- 2002 Construction Cost
  - 100 miles x 5,280 feet (1 mile) = 528,000 Linear Feet
  - 528,000 LF x $55/LF = $29,040,000
- 1982 Construction Cost
  - $29,040,000 x 60% (1982 index at 88.5*) = $17,424,000
  - $17,424,000 is your 1982 Estimated Historical Cost

*88.5 index is 60% of the 2002 Construction Cost Index at 148.6

Exercise #3

Calculating Estimated Historical Cost for Infrastructure

- Assume:
  - The county's road department resurfaced 40 miles of 20 ft. wide road during 1996.
  - Calculate the 1996 estimated historical cost using the Infrastructure Construction Cost Index.

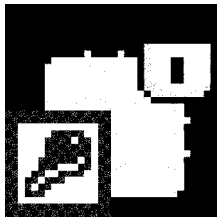
Exhibit 5 Infrastructure Construction Cost Index

Exercise #3 - Solution

- 40 miles of resurfaced road in 1996
- 2002 Construction Cost
  - 40 miles x 5,280 ft. (1 mile) = 211,200 ft.
  - 211,200 ft x $10/LF = $2,112,000
- 1996 Construction Cost
  - $2,112,000 x 81% (1996 index at 120.2*) = $1,710,720 Estimated 1996 Historical Cost

*120.2 index is 81% of the 2002 Construction Cost Index at 148.6

Establishing Rural Road/Street System Values*



Roads.mde

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Questions and Answers

Q. Are counties *required* to use the Road Program to value infrastructure assets?

A. No, this is a tool provided to assist you. Counties may choose another method, but must document methodologies and decisions.

Depreciating Infrastructure

Five elements must be known to calculate depreciation

1. Date infrastructure was placed in service
2. Historical cost or fair market value for donated infrastructure
3. Estimated useful life
4. Salvage value (if any)
5. Depreciation method
   - Straight-line Depreciation

Infrastructure Useful Lives

- Most infrastructure has an identifiable useful life and can be depreciated over that life.
- Refer to Exhibit 5 or Road Segment Program.
  - These are only estimates and can be modified for assets with a particular usage to fit your situation.

Infrastructure Salvage Value

- Salvage Value Estimates
  - 20% of construction costs for paved roads/streets and bridges
  - 10% of construction costs for unpaved roads and sidewalks
  - Salvage value for infrastructure would include the road bed which would not be replaced during resurfacing

Calculating Depreciation for Infrastructure

- 1982 Estimated Historical Cost of 100 miles of Paved Road = $17,424,000
- (Historical Cost – Salvage Value) divided by Useful Life = Annual Depreciation
  - **($17,424,000 – (17,424,000 x 20% = $3,484,000)/25 years = $557,600 Annual Depreciation**
- Age of Asset x Annual Depreciation = Accumulated Depreciation
  - **21 years x $557,600 = $11,709,600 Accumulated Depreciation**
- Cost – Accumulated Depreciation = Asset Value at June 30, 2003
  - **$17,424,000 - $11,709,600 = $5,714,400 Asset Value at June 30, 2003**

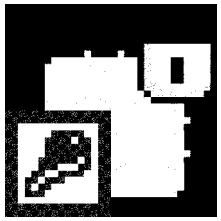
Exercise #4
Depreciating Infrastructure

- $1,710,720 Estimated 1996 Historical Cost for 40 miles of Resurfaced Road
- Resurfaced Roads have no salvage value
- Using the straight-line depreciation method, calculate the Annual Depreciation and the Asset Value as of June 30, 2003

Exercise #4 - Solution

- Resurfaced Road Historical Cost = $1,710,720
- Cost divided by Useful Life = Annual Depreciation
  - $1,710,720/12 years = $142,560 Annual Depreciation
- Age of Asset x Annual Depreciation = Accumulated Depreciation
  - 7 years x $142,560 = $997,920 Accumulated Depreciation
- Cost – Accumulated Depreciation = Asset Value at June 30, 2003
  - $1,710,720 - $997,920 = $712,800 Asset Value at June 30, 2003

Calculating Depreciation on Infrastructure



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Who does this apply to?

- Phase II Governments
  - All infrastructure acquired or constructed after June 30, 2002 must be reported immediately.
  - They have 4 additional years to report infrastructure assets acquired between June 30, 1980 and June 30, 2002 (no later than June 30, 2007).
  - Reporting infrastructure assets acquired or constructed prior to June 30, 1980 is optional.

What exactly does this mean for Phase II Governments?

If road is resurfaced on June 29, 2002:

- Immediate reporting of the resurfacing is not necessary since it is prior to

  July 1, 2002.

- Have **four** additional years (no later than June 30, 2007) to compile **infrastructure** assets acquired or constructed between June 30, 1980 and June 30, 2002.

Who does this apply to?

- Phase III Governments
  - Required to report newly acquired or constructed infrastructure after June 30, 2003 immediately
  - **NOT** required to report infrastructure acquired or constructed prior to July 1, 2003
  - Phase III Governments **strongly** encouraged to report infrastructure acquired prior to July 1, 2003 – especially if there is related debt reported in the financial statements but can be done anytime during or after implementation year

What exactly does this mean for Phase III Governments?

If road is resurfaced on June 29, 2003:

- Reporting the resurfacing is not required since it is prior to July 1, 2003.

Management's Discussion and Analysis

Management's Discussion & Analysis (MD&A)

Information required to be presented in the audit report, separate from the basic financial statements.

Where is the MD&A located in the audit report?

MD&A, prepared by the county's managers, precedes the presentation of basic financial statements.

When should MD&A be completed?

- Begin upon completion of the Treasurer's Annual Settlement or 4th Quarter Financial Report

- Submit to auditors before the end of fieldwork

Common Components of MD&A

- Introduction
- Financial Highlights
- Overview of the Financial Statements
- Financial Analysis of the County as a whole
- Financial Analysis of the County's Funds

Common Components of MD&A (continued)

- General Fund Budgetary Highlights
- Capital Assets
- Debt
- Economic Factors and Next Year's Budget and Rates
- Contacting the County

Introduction

- Provides an overview
- Read in conjunction with the financial statements

Financial Highlights

- How did net assets change over the year?
- Did governmental activities revenues exceed expenditures?
- Did business-type activities revenues exceed expenditures?
- Did the County receive any significant grants?
- Was a large portion of debt paid-off? Incurred?
- How did the general fund do in the current year? Deficit or surplus fund balance?

Overview of the Financial Statements

- The two government-wide financial statements
  - Statement of Net Assets
  - Statement of Activities
- The various fund financial statements
- Notes to the financial statements
- Required Supplementary Information
- Basis of accounting

Financial Analysis of the County as a whole

- Did net assets increase or decrease during the year and what brought about this change?
- Did governmental activities increase or decrease? What was the reason?
- Did business-type activities increase or decrease? What was the reason?

Financial Analysis of the County's Funds

- Did the County's funds increase or decrease over the course of the year?
- What brought about these increases or decreases?
- Did taxes increase or decrease and why?
- Was a major construction project started?
- Did major types of expenditures increase or decrease and why?

General Fund Budgetary Highlights

- Did the County amend the original budget for the general fund and why?
- How much did revenues and expenditures exceed or fall below the final budget and why?

Capital Assets

- Did the County invest more funds in capital assets in the current year?
- What types of capital assets did the County purchase?
- How did the County fund these capital assets?

Debt

- Did the County's debt increase or decrease during the year? Why?
- Did the County obtain new debt?
- Did the County pay-off current debt?
- Is the debt related to governmental activities or business-type activities?

Economic Factors and Next Year's Budget and Rates

- What is currently known that will impact the next budget?
- Did tax rates increase?
- Will the County start fee pooling?
- Did the County impose a new tax?
- Was a lawsuit recently settled?

Contacting the County

- If citizens have questions, they may call, write or email.
  - Telephone number
  - County address
  - Email address

Auditor's Reporting and Required Supplementary Information

- Failure to prepare an MD&A will not affect the auditor's opinion on the financial statements
- Auditors must include an explanatory paragraph if:
  - MD&A is omitted, or
  - MD&A contains materially misleading information

Questions and Answers

Q. If a county transitions to a 70,000+ county, how would large changes in the financial statements be explained?

A. MD&A provides a great opportunity to explain these types of variances.

Questions and Answers

Q. For counties that prepare a CAFR, should the letter of transmittal duplicate any information presented in the MD&A?

A. No. MD&A and the letter of transmittal should not contain duplicate information. Since MD&A is a required GASB 34 element, it should take precedence over the GFOA requirements for the letter of transmittal contents.

GASB Statement 34 Resources from APA

- APA Website (www.kyauditor.net)
  - GASB 34
    - E-mail link to GASB 34 hotline
    - Frequently Asked Questions from Local Officials
    - Training Materials
    - Useful Links